178608

LAW OFFICES
McCARTHY, SWEENEY & HARKAWAY, P.C.
SUITE 600
2175 K STREET, N.W.
WASHINGTON, D. C. 20037
(202) 393-5710

LAWRENCE W. BIERLEIN
DOUGLAS M. CANTER
JOHN M. CUTLER, JR.
ANDREW P. GOLDSTEIN
STEVEN J. KALISH
RICHARD D. LIEBERMAN
HARVEY L. REITER

OF COUNSEL
WILLIAM I. HARKAWAY
KAREN R. O'BRIEN
DANIEL J. SWEENEY

FACSIMILE
(202) 393-5721

E-MAIL
MSH@MSHPC.COM

WEBSITE
HTTP://WWW.MSHPC.COM

RECEIVED
MAY 15 2000
MAIL
MANAGEMENT
STB

May 16, 2000

Mr. Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, DC 20423

ENTERED
Office of the Secretary
MAY 16 2000
Part of
Public Record

Re: Ex Parte No. 582, Public Views on Major Rail Consolidations

Dear Secretary Williams:

Enclosed for filing are a signed original and 25 copies of Comments of Transition Corporation Pursuant to Advance Notice of Proposed Rulemaking in the above-captioned case. Also enclosed is a diskette in WordPerfect 5.1 containing the same document.

Sincerely,

Andrew P. Goldstein

Andrew P. Goldstein
Attorney for
Transition Corporation

Enclosures

APG/rmm

(7860)

ORIGINAL

BEFORE THE

SURFACE TRANSPORTATION BOARD

EX PARTE NO. 582 (SUB-NO. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

COMMENTS OF TRANSITION CORPORATION PURSUANT TO ADVANCE NOTICE OF PROPOSED RULEMAKING

Andrew P. Goldstein
McCarthy, Sweeney & Harkaway, P.C.
Suite 600
2175 K Street, N.W.
Washington, DC 20037
(202) 393-5710

Attorney for
Transition Corporation

Dated: May 16, 2000

BEFORE THE

SURFACE TRANSPORTATION BOARD

EX PARTE NO. 582 (SUB-NO. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

COMMENTS OF TRANSITION CORPORATION PURSUANT TO ADVANCE NOTICE OF PROPOSED RULEMAKING

Transition Corporation ("TC"), an agent for rail shippers and receivers, submits these comments in response to the Advance Notice of Proposed Rulemaking ("ANPR") served in this proceeding on March 31, 2000 ("March 31 Decision").

I. INTRODUCTION

Virtually all of the major rail consolidations that have occurred in the recent past have produced some measure of merger-related service disruption or have failed to match up to the applicants' promises, leaving the shipping public harmed by poor service or facing other undisclosed post-merger consequences, with few concomitant merger benefits.

For instance, service disruptions resulting from the acquisition of Conrail by CSX Transportation, Inc. ("CSX") and Norfolk Southern Railway Company ("NS")[1] have produced notorious problems for shippers since the "take over" date of June 1, 1999, through the present. The much publicized "meltdown" of Union Pacific Railroad Company ("UP") following its 1996 acquisition of Southern Pacific Transportation Company[2] was so egregious as to prompt the Board to institute a special proceeding, Ex Parte No. 573, Rail Service in the Western United States, to hear testimony on the extent of the damage caused to shippers and communities. Even the 1995 merger of The Atchison, Topeka and Santa Fe Railway Company into Burlington Northern, Inc.[3] left service problems in its wake. Ibid.

The problems generated by these transactions have been highly injurious and destructive to shippers. Post-merger carrier malfunctions and resultant shipper injuries have taken many forms, including drastically reduced transit and cycle times, the inability of the rail system to move goods in a timely or responsive manner, claims against shippers by their customers, the

---

[1] See CSX Corporation and CSX Transportation, Inc., et al. -- Control and Operating Leases/Agreements -- Conrail, Inc. and Consolidated Rail Corporation, STB Finance Docket No. 33388, Decision No. 89, July 20, 1998 ("Conrail Acquisition").

[2] Union Pacific Corporation, et al. -- Control and Merger -- Southern Pacific Rail Corporation, et al., STB Finance Docket No. 32760 ("UPSP Merger").

[3] Burlington Northern, Inc., et al. -- Control and Merger -- Santa Fe Pacific Corporation, et al. (??), STB Finance Docket No. 32549 ("BNSF Merger").

use of alternate transportation more expensive than rail, disruption of production schedules, plant slow-downs, and loss of business. Poor rail service starts a chain reaction that spreads throughout the economy, as the inability of one companmy to produce a raw product for lack of materials or to deliver it if produced for lack of rail service, becomes the next company's inability to manufacture and deliver the finished product.

Well-publicized estimates of the damages suffered by the shipping public as a result of rail mergers gone awry run into billions of dollars, and it is doubtful that such estimates take into account the full costs to society of widespread rail service deterioration. Claims filed by shippers with the merged carriers seldom are paid in full, often because carriers reject out-of-hand certain categories of claims, such as those for under-utilization of manufacturing facilities, disruptions in plant operations, or the inability to meet sales commitments. These forms of damages easily can outstrip the claims that railroads generally are willing to pay for such things as trucks substituted for rail or the rental of additional rail cars.

II. SUMMARY OF POSITION

TC believes that the Board's merger rules should focus on making railroads fully accountable for the harmful consequences of mergers and for whatever representations they make to the Board in pursuit of mergers, including the applicants' failure to disclose post-merger consequences.

Mergers by definition have the potential to reduce competition.[4] Both rail customers and shareholders should be provided with clear statements of how the merging railroads will exercise their newfound market power, and in those instances where adequate, clear disclosure is not made by the merging railroads, post-merger changes that are contrary to the facts disclosed in the merger process should be severely circumscribed or barred by the Board. Additionally, railroads should be held strictly and fully liable to their customers for the economic consequences of service problems that result from the merger.

The key to this process should be the intervention of an independent panel of experts to scrutinize the application and to monitor the post-merger process on an on-going basis. If there is any one, single glaring failure in the present merger process, it is, in TC's view, the lack of a responsive method to hold the carrier promptly and completely accountable for its actions and omissions. An independent panel with no responsibilities other than merger monitoring may be in a better position than the Board alone to accomplish that goal.

This panel can function in the same manner as the third-party consultants employed by the Board (at carrier expense) to investigate and report on environmental issues in rail construction and other cases. Panel members can be selected in the same manner

---

[4] The Board has referred to the evolution of rail mergers over the past 20 or more years as a process of capacity rationalization. March 31 Decision, slip op. at 3. That is a process which inherently entails the elimination of route and other competitive choices.

as the Board's rules now provide for the selection of arbitrators. Where prior mergers have taken place, the Board has responded after-the-fact to a developing crisis[5] or has simply instituted various data reporting requirements on the part of the carriers involved. Perhaps the Board's resources do not permit a more active response; but the fact remains that most steps heretofore taken by the Board have not made railroads strictly accountable for their merger commissions and omissions that cause harm to their customers.

The ANPR touches upon accountability issues under the heading **Safeguarding Rail Service.** TC is confining its comments to issues of accountability. Its presentation is divided into two parts: pre-decisional issues and post-decisional issues.

III. PRE-DECISIONAL ISSUES

The Board's merger and consolidation regulations at 49 C.F.R. § 1180, et seq., require merger applicants in major (Class I) transactions to submit market analyses, operational data, and financial information. See 49 C.F.R. § 1180.7, 1180.8, and 1180.9. These data become an important foundation for the factors the Board is required to consider under 49 U.S.C. § 11324. That section directs the Board to approve and authorize a jurisdictional consolidation between two Class I railroads when the Board finds the transaction is consistent with the public interest, and instructs the Board to "consider at least -- (1) the effect of the proposed transaction on the adequacy of transportation to the

---

[5] E.g., Ex Parte No. 573, supra.

public; (2) the effect on the public interest of including, or failing to include, other rail carriers in the area involved in the proposed transaction; (3) the total fixed charges that result from the proposed transaction; (4) the interest of rail carrier employees affected by the proposed transaction; and (5) whether the proposed transaction would have an adverse effect on competition among rail carriers in the affected region or in the national rail system."

Applicant carriers make various representations to satisfy these criteria. For example, in the Conrail Acquisition, the Board found that "[a]pplicants have provided ample evidence to demonstrate that they will have much more than a sufficient flow of funds to meet their financial obligations without having to raise rates to shippers at all." Slip op. at 63. Nevertheless, CSX shippers were notified recently that they face rate increases of six to eight percent -- substantially larger than the normal annual increases of 1.5 to 2.5 percent -- because of "pockets of serious congestion on our railroad" in the wake of CSX's disastrous take-over of Conrail.[6/] Similarly, the "more efficient" service promised by UP following its merger with the Southern Pacific[7/] may be realized at some point in the future, but certainly was not realized during the first several years following the merger.

6/ Letter of March 13, 2000 from John P. Sammon to CSX customers.

7/ UPSP Merger decision, slip op. at 113.

Comprehensive evidence of expected merger benefits and potential adverse merger effects is needed not only to determine the rationale of the consolidation, but also to permit the Board effectively to evaluate post-merger performance relative to pre-merger claims. Comprehensive and quantifiable pre-decision scrutiny will enable sound post-merger regulatory assessment, providing not only the ability to identify instances that need to be rectified, but also laying the foundation for standards, service and otherwise, to which railroads can be held accountable.

A. Changes to Merger Rules.

Although the Board's present rules often lead to the production of certain of the data which TC has included in its proposed rules, the present rules are, in fact, relatively general in their approach to merger analysis. TC believes that greater specificity is required as part of a process holding the merged carrier to a stricter level of accountability for both its representations and post-merger behavior. The specific rules suggested by TC are set forth in the Appendix hereto.

B. The Applicants' Data Should be Scrutinized and, If Need Be, Challenged by an Independent Panel of Experts Acting on Behalf of the Public.

The standard which governs mergers is consistency with the public interest, yet most of the shipping public affected by Class I rail mergers are effectively barred from participating in a merger proceeding by the overwhelming volume and complexity of the data involved and the very substantial costs of retaining both counsel and appropriate experts to evaluate the applicants' presentation and, if need be, to present contrary views to the Board.

Evaluation of the statute's public interest criteria would be enhanced on behalf of shippers if that task were approached in the same manner as the Board approaches its responsibilities under the National Environmental Policy Act ("NEPA"), where the highly technical and complex matters to be evaluated are examined on behalf of the Board by a Third-Party Consultant, selected by the Board pursuant to 49 C.F.R. § 1105.4(j), but paid for by the applicant railroads.

Similarly, the Board can retain a panel of independent experts -- economists, accountants, knowledgeable operating personnel, attorneys, and others if necessary -- to act in the nature of a public counsel, authorized to engage in discovery and instructed to make a critical analysis of the applicants' representations, presented in the form of a public report to the Board, in time for others to utilize the report in their evidentiary presentations. The appropriate experts can be selected by the Board from a roster of persons established in a manner similar to that now provided for in the selection of arbitrators to be designated pursuant to 49 C.F.R. § 1108.6.[8/] While these steps no doubt will be costly, they

---

[8/] The use of special outside counsel to assist the Interstate Commerce Commission in the development of a record is not without precedent. See Chesapeake & O. Ry. -- Control -- Baltimore & O. R. Co., 317 I.C.C. 261, 298-99 (1962), recounting the retention of Mr. (later Mr. Justice) Louis Brandeis to represent the public in a proceeding before the Commission.

may not be any more costly than the payments that can be required of an applicant as compensation for the Board's Third Party Consultant in connection with NEPA matters that arise in a major market extension case. They will pave the way for a much more broad-based analysis of the merger proposal and for more responsive post-merger enforcement, and may well save money over the long run if these expenditures do contribute to conditions that make post-merger errors a less attractive alternative to the merged carrier.

IV. POST-DECISIONAL ISSUES

A. Monitoring the Merger

When service disruptions are traceable to a merger or consolidation, in whole or in part, there should be clearly available recourse of both a remedial and monetary nature.

Effective recourse requires effective monitoring of post-merger operations. Ideally, such monitoring should be performed entirely by the Board, but limitations on its resources may make that unfeasible and suggest the use of an auxiliary mechanism. An independent panel can assist the Board in performing post-merger monitoring in the same manner as proposed above for the analysis of asserted pre-merger benefits and projections.

The Board has partially recognized the significance of post-merger monitoring, having retained and, to some extent, exercised, post-merger oversight jurisdiction in prior rail consolidations, e.g., UPSP Merger and Conrail Acquisition. TC suggests, however, that the Board must go further and place merger applicants on notice that the Board will exercise its jurisdiction not merely to collect data, but to revise merger conditions as a remedial step where it is evident that mismanagement of the merger has lead to continuing service problems that deprive the public of the benefits promised by the application or that the merger is a continuing source of economic injury to shippers.

Moreover, the Board should use its authority to assess the extent of service departures from pre-merger service levels and from merger application representations. For example, the continuing service problems being experienced with CSX following its Conrail acquisition are attributed variously by CSX to just about every cause under the sun except its Conrail acquisition -- unexpected traffic increases, weather conditions, and unanticipated track maintenance problems, to name a few. As part of a process of merger accountability, the Board should make periodic findings, preferably on a quarterly basis, of service performance criteria that have fallen below either pre-merger levels or below those post-merger service standards which the applicants may have substituted for their pre-merger performance.

The principal service area to be examined should be transit times. In the past, the Board has utilized indicia such as terminal dwell time and cars on line to measure a railroad's post-merger operating status. While these standards may have some value, they are not as significant as the transit time for both loaded and empty moves. Transit time should be measured by major commodity group, shipment size (e.g., single cars, multiple cars and trains), and either region or traffic corridor, aggregated within those groupings to avoid disclosure of individual shipper movements.[9] The Board should require the applicant carriers to produce all such data for an appropriate pre-merger period and for an appropriate post-merger period.

The post-merger process also should include monitoring the carrier's adherence to its merger commitments. This can be accomplished in part by traffic comparisons, but may require a system whereby customers periodically rate the merged carrier's performance in areas such as service responsiveness, open routings, and similar matters.

B. Monitoring Mechanism

The mechanism for monitoring post-service issues should be the same independent panel established to analyze the merger application. This panel should share authority to establish monitoring requirements and to evaluate monitoring information, submitting periodic reports to the Board that are also available for public inspection. The Board can then accept or reject the panel's conclusions on an expedited timetable, much as it is

---

[9] This type of disclosure would not inhibit any carrier's ability to compete. The disclosure of aggregated transit time data is not inherently anti-competitive, as evidenced by the fact that Burlington Northern Santa Fe discloses, on its website, cycle time data for its entire grain car fleet. To the limited extent that railroad competition remains in the United States, the disclosure of transit time data would be akin to the disclosure and public reporting of airline on-time performance data required by the Department of Transportation. To the extent that railroads no longer face competition in given markets, such as for many types of bulk traffic, disclosure of transit time and cycle time data cannot have anti-competitive effects by definition.

authorized to due pursuant to 49 C.F.R. § 1108.11 with respect to arbitration awards.

The monitoring activity is a crucial element of post-merger accountability. Without an aggressive, public monitoring effort, many shippers will be forced to forego just compensation for merger-related economic damage where that damage has not risen to a sufficiently high level to justify expensive litigation. Moreover, centralized merger monitoring will provide an experienced cadre of experts who rapidly will become familiar with the facts and the issues, rather than leaving the monitoring process in strictly private hands, where each shipper approaches the task without any special experience, expertise, or familiarity with the available data.

C. **Consequences**

Where merger-related service failures are found to have occurred, or defaults are found in other merger commitments by the independent panel, its findings should obviate the need for further evidentiary proceedings on the issue of culpability. The panel's findings should be available as a basis for whatever remedial action the Board might wish to take (for instance, in the form of authorizing alternative competitive service -- a remedy which the Board should retain the right to impose in any merger proceeding) or for shipper damage claims. Shippers should have to establish only the extent of their individual merger-related damages in order to recover.

The Board should make it clear that the measure of damages for which carriers will be liable is one which extends to all consequences of carrier fault, such as business disruptions, production disruptions, equipment underutilization, and any other reasonably calculated consequence of the merger.

Individual shipper recovery should be allowed to proceed either before the Board or in any other forum available (such as arbitration, if the shipper and the railroad have otherwise agreed to use that method of dispute resolution). The Board's authority to impose conditions to the approval of any merger would appear to be broad enough to allow the Board to require a merging carrier to assent to this manner of jurisdiction as a condition to exercising any authority which the Board might grant.

V. CONCLUSION

The Board should be commended for seeking to reexamine its approach to Class I rail mergers now that the remaining few Class I carriers are arguably poised to attempt a final round of consolidations.

TC believes that the Board's single most important contribution to current-day mergers is the enforcement of accountability by the merged carriers for the consequences of the merger, and urges the Board to adopt rules that strictly apply accountability.

Respectfully submitted,

Andrew P. Goldstein

Andrew P. Goldstein
McCarthy, Sweeney & Harkaway, PC
Suite 600
2175 K Street, N.W.
Washington, DC 20036

Attorney for
<u>Transition Corporation</u>

CERTIFICATE OF SERVICE

I hereby certify that I have caused a copy of the foregoing pleading to be served on all parties of record ;by first-class mail, postage prepaid, this 16th day of May, 2000.

Andrew P. Goldstein

Andrew P. Goldstein

APPENDIX A

A. <u>Changes to Merger Rules</u>.

Applicants should qualify and quantify the expected impact of projected changes from the proposed merger on railroad customers (shippers and receivers), the merging railroads, other railroads, employees, and society in general. This analysis should address both the benefits and adverse impacts, if any, projected to flow from the merger. The following proposals are offered for changes to the merger rules involving major transactions:

1. <u>Projected benefits to be identified and discussed should include, but not be limited to</u>:

(A) <u>Economic efficiency/productivity</u>:

(1) The applicants should identify the location, condition and quantity of track structure, yards, fixed facilities and other assets to be consolidated, abandoned, or sold. The resulting savings in railroad operating expenses should be shown, by item, and the methodology used to identify the affected facilities and the estimated cost savings should be explained.

(2) Where asset utilization is to increase, the applicants should provide evidence as to how economies of density and scale will be

realized. Specificity should be required in regard to the financial benefits of productivity gains, and the applicants should be required to estimate the percentage of the productivity gains which will be passed on to railroad customers and the percentage maintained to improve railroad earnings, with disclosure of the basis for these percentages.

(3) Details should be provided as to expected reductions in employment by type of position, location, and timing of terminations.

(B) Revenue enhancement:

(1) The applicants should be required to identify expected traffic diversions from other railroads and transport modes to the merged railroad and to quantify the financial impact of those diversions on the merged railroad, with specificity regarding the methodology used to estimate traffic diversions and impacts.

(C) Customer service:

(1) The applicants should identify service standards and improvements to current and potential customers, addressing such performance standards as market access (with detailed explanations of how gateway access will be maintained, including economic terms of gateway access); availability of cars; reliability of on-time delivery, transit times, and cycle times;

(2) An explanation should be required of how the proposed merger will affect overall railroad capacity, terminal congestion, track maintenance, equipment availability, and other measures affecting overall performance, with specific disclosure of time tables for implementation of improvements and maintenance.

(D) Competitive Changes

(1) The applicants should discuss how the merger will alter railroad competition, with specific

reference to any added choices of carriers or routes for railroad customers, including economic data such as switching rates or trackage rights fees or rate changes that may impact competitive choices. This discussion should identify specific geographic markets and commodities affected.

(2) There should be disclosure of how changed route structures will detract from railroad competition, again identifying affected geographic markets and commodities.

(E) <u>Financial impact</u>:

(1) The applicants should describe how the financial viability of the merged railroad will be enhanced. The financial analysis should include five year annual projections of operating income, return on investment, and cash flow.

(2) The impact of the merger on capital investment should be identified, specifically with regard to, among other categories of in-

vestment, track structure, terminals, locomotives, freight cars, and intramodal facilities.

2. Potential adverse effects to be identified and discussed should include, but not be limited to:

(A) Service disruptions and deficiencies:

(1) Expected service disruptions should be detailed by geographic location, including plans and timetables to resolve or minimize such disruptions;

(2) The applicants should set forth any service guarantees and penalties the merged railroad is willing to pay if post-merger service levels fall below pre-merger service levels or fail to meet pre-merger projections, including the base line proposed for measuring pre-service performance. These penalties should be comprehensive, including damages such as impeded asset utilization and lost sales.

(B) Reduced shipper accessibility:

(1) There should be disclosure of access points (gateways) now

available to shippers that will be closed or made inaccessible through other actions, such as rate changes that alter competitive relationships between shippers.

(2) The applicants should identify geographic and commodity markets which will be adversely affected by reroutings or other post-merger activities, including losses of source competition.

(C) Financial burden on merged railroad: The applicants should --

(1) Set forth the merger funding plan, including added debt burden;

(2) Set forth any impact on the surviving entity's debt-equity ratio and earnings-to-debt ratio;

(3) Describe how merger costs will be recovered, including types of cost recovery and timing; and

(4) Set forth the present bond ratings (using not less than three major bond rating services) of the

merging railroads and the expected bond ratings of the merged railroad.

g:\mcd\transiti.582